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C O N F I D E N T I A L SECTION 01 OF 03 TOKYO 003660

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PLEASE PASS TO USTR WENDY CUTLER AND MICHAEL BEEMAN

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SUBJECT: VICE TRADE MINSITER KUSAKA SUPPORTS CLOSER
US-JAPAN ECONOMIC POLICY COORDINATION

¶1. (C) Summary. METI Vice Minister Kazumasa Kusaka praised the recent US-Japan Subcabinet level meetings during a recent meeting with DCM and EMIN. He added insights into the Nikai proposal for an ASEAN Plus Three FTA and apologized for not consulting with the U.S. before making the proposal. Kusaka also revealed his thinking on US-Japan relations, the US-Japan Investment Initiative, Japan-China relations, Minister Nikai's future prospects, the LDP presidential election and upcoming METI rotations. End summary.

Subcabinet Discussions

¶2. (C) METI Vice Minister Kazumasa Kusaka told DCM and EMIN during a recent meeting that he was happy with the recent US-Japan Economic Subcabinet discussions in Washington and said they had been very useful. He was especially pleased that the format (fewer participants on the Japanese side) had left more time for discussion and give-and-take. He believes these discussions should continue regularly.

Asian Architecture

¶3. (C) As a result of the Subcabinet discussions, Kusaka believed the United States now understood better (even as it did not agree with) Japan's interest in the Asian regional FTA initiative. In Japan's view an ASEAN Plus Three regional trade initiative is inevitable. The pull of China is just too strong. For Japan the choice is not between APEC and the ASEAN Plus Three. Rather, the choice is between participating in the ASEAN Plus Three and trying to shape it in Japan's terms, or in being left out as China and Korea pursue trade liberalization in a regional arrangement with ASEAN. METI's proposal to broaden (by including Australia, New Zealand and India) and deepen (by including more issues under the scope of a regional FTA) was an attempt to weaken the influence of China and to delay the pace of the FTA talks. Particularly by including India the regional trade liberalization effort would slow because the Indians love to talk and talk, Kusaka claimed. Japan did not want to choose between the United States and Asia, Kusaka continued.

¶4. (C) Therefore Japan, even as it pursues this regional trade initiative, also wants to strengthen trans-Pacific institutions like APEC and ARF. Japan will be interested in working with the United States on APEC initiatives. However, APEC is an unwieldy institution with many members so it is difficult to move ahead. In particular, the Latin members have different interests than their Asian counterparts, Kusaka claimed.

Nikai Proposal for ASEAN Plus Three FTA

15. (C) Kusaka agreed with DCM that Japan should have coordinated better with the United States by signaling in advance METI's thinking on the proposal to broaden and deepen the ASEAN Plus Three FTA concept. He joked that even other Japanese ministries had been surprised by the proposal. He said MAFF was strongly opposed because by including Australia, MAFF fears Japan will be forced to make more concessions on agricultural market access issues. In contrast MAFF favors the ASEAN Plus Three approach. MOF is indifferent, but does not want to include Australia and India in the ASEAN Plus Three Finance Ministers process. MOF, Kusaka claimed, is talking to Treasury about the Chang Mai Initiative and the Manila declaration, but despite US misgivings, MOF is determined to move ahead with an Asian financial integration program. The main reason was that MOF thought the United States and the IMF had mishandled the Asian financial crisis and that the Asian countries were looking to Japan for leadership. This was an area where Japan, not China, had something to offer the Asians, Kusaka noted. Because of this background MOF was neutral on the Nikai proposal as long as it did not interfere with its own work in ASEAN Plus Three. Kusaka also said MOF was rather negative on financial work in APEC as that organization was just too unwieldy. Kusaka admitted that MOFA was also uncertain about the Nikai proposal. However, he noted, MAFF, MOF, and MOFA were all committed to pursuing trade liberalization in the ASEAN Plus Three context. Japan's choice, he claimed, was not between APEC and ASEAN Plus Three. ASEAN Plus Three trade liberalization was inevitable. In this context the Nikai proposal was the least bad alternative. Kusaka did not have an answer for what this

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policy meant for Taiwan. Kusaka also acknowledged the DCM's points about the need to work closely with the United States and to strengthen the US role in Asia.

Managing US-Japan Economic Relations

16. (C) Kusaka thought the Koizumi-Bush summit was the wrong place to launch any new initiative. The new Prime Minister would dislike being bound by dramatic new commitments made in the waning days of the Koizumi term. Therefore we were better off making a more general statement about strengthening economic relations and then working to launch a new initiative in the fall that the new Prime Minister could claim as his own. For this reason Japan would consider various options but would remain non-committal. Kusaka said this did not mean the bureaucracy was uninterested in pursuing greater economic integration with the United States, the hold up was political. Kusaka said METI was interested in two ideas the United States had raised in the Subcabinet -- secure trade and IPR. There were other areas as well where perhaps the United States and Japan could reduce business costs, such as the pharmaceutical approval process.

Prospects for a US-Japan FTA?

17. (C) Kusaka thought it was premature for the two governments to begin discussing this topic -- mainly because of Japan's defensive concerns over agriculture. That said, Kusaka has asked the Japanese business community to begin considering seriously the economic implications of an FTA. He said he had talked with incoming Keidanren Chairman Mitarai, who had agreed to establish an FTA committee so that Keidanren could begin participating in track two discussions with US business and academic counterparts. Such efforts might eventually generate momentum towards a bilateral FTA, but in the short term the two governments could look to areas outside of tariffs where

the two sides could make progress. Kusaka was also interested in the ACCJ's trade white paper and he had heard the ACCJ was supporting greater bilateral economic integration.

Japan-China Relationship

¶18. (C) Kusaka said he had been warning the Japanese business community to diversify its investments outside of China. He thought that as a result of SARS and the anti-Japanese demonstrations last spring, we were beginning to see a modest shift as businesses began looking to alternatives like Vietnam and India. This did not mean that Japanese companies would pull out of China, but rather they would hedge their investment bets. Ironically, he noted, political relations between Japan and China were improving. He thought that the Chinese wanted better relations and that after the new government was formed this fall we would see more high level visits and closer ties. Kusaka said the Japanese government understood the US would welcome this improvement of ties.

US-Japan Investment Initiative

¶19. (C) Kusaka noted with satisfaction that at the US-Japan Economic Subcabinet, the US side had asked to continue its Investment Initiative. EMIN reviewed briefly two key items on the policy agenda -- triangular merger provisions and labor mobility. METI's role this fall on tax provisions and restrictions on the type of stock that could be used would be critical, EMIN pointed out. Kusaka expressed concern that the CFIUS process might chill FDI flows into the United States. Both sides agreed that continued work in this area was warranted.

Minister Nikai's Future Prospects

¶10. (C) Kusaka said Nikai would be an influential politician in the years to come. He was a potential candidate for Chief Cabinet Secretary or an important party position in the new government. Kusaka claimed that Nikai was not as particularly "pro-China" as the Japanese press had reported. That said, Nikai had been impressed by the warm treatment he received in his recent trip to China and had reciprocated when Minister Bo Xilai came to Japan. Kusaka

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hinted he was a bit concerned about Nikai's views toward the United States and noted that METI was arranging for him to visit Washington DC from July 23-25. According to Kusaka, Nikai was not so much a man of conviction as a politician who valued human relationships. He now had established close friendships with many Chinese counterparts so METI wanted to utilize the Washington trip to allow Nikai to also establish close ties with US counterparts. Ambassador to the U.S. Ryozi Kato was arranging appointments for him with USTR Schwab and former USTR Portman. They hoped he could also see Secretary Rice and some friends of Japan from the private

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sector. Kusaka stressed this visit was important, not so much because of Nikai's role as METI Minister, but more from the perspective of his future role in determining LDP policies.

LDP Presidential Election

¶11. (C) Kusaka said Chief Cabinet Secretary Abe did not really have clear economic policies (or a deep understanding of economic issues) so it was too soon to predict the economic priorities of an Abe administration. One concern was that Abe had not had experience running a large ministry. Therefore he would need a strong Chief

Cabinet Secretary and a strong deputy to help him govern. One possibility was Nikai, but another strong rumor was that Defense Minister Nukaga would become Chief Cabinet Secretary. Nukaga was from a different faction, but he and Abe were close.

METI Personnel Reshuffle -----

¶12. (C) Kusaka declined to speculate in detail on personnel moves in METI other than to confirm he would retire soon. He said METI was due for a "major reshuffle" this July because there had been few moves last year. He hinted (and we have heard this elsewhere) that DG Kitamura would assume his job as Vice Minister of International Affairs when he encouraged us to "maintain contact" with Kitamura in the future. Kusaka also said MOF would experience a major reshuffle this July. Both moves would occur after the CEEP announced the new economic policy priorities in mid-July.

Comment -----

¶13. (C) Kusaka's retirement will be a loss to the U.S. and METI. He has been a friend to the U.S. and has talked openly and honestly with us. Helpful to us in many different arenas, he recognizes the importance to Japan of a strong U.S. presence in Asia.
DONOVAN